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SUBJECT: IMF ARTICLE IV TEAM GIVES ANGOLA HIGH MARKS

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¶1. (SBU) Summary. On June 5, 2007, the IMF Article IV team, which is close to winding up its first visit to Angola since the GRA definitively walked away from a formal program with the IMF (reftel), presented a preliminary summary of its findings to representatives of embassies and international organizations. Calvin McDonald, Advisor to the IMF,s Africa Department, predicted that the Angolan economy would grow by 35 percent in 2007. He reckoned that the economy is now at a medium risk of debt distress over the long term as its foreign exchange reserves have more than doubled to USD 8.5 billion dollars. While budgets have grown, the execution of capital expenditures as laid out in the budgets remains low -- at about 50 percent -- and the GRA must improve its capacity for medium-term planning. Although McDonald readily admitted that the IMF has a long way to go on critical sticking points involving transparency, he said his team had enjoyed a good working relationship with the Angolans) essential in a process of continuous interchange with host-country financial officials -- and expressed his confidence that the IMF-Angola relationship is a solid and continuing one. This may be a lower-level delegation than IMF sent when it hoped an agreement was imminent, yet ready and willing to tackle technical issues with the Angolans. End Summary.

¶2. (SBU) On June 5, 2007, Calvin McDonald, Advisor to the Africa Department of the IMF and leader of the Article IV consultation team now nearing the end of its visit to Luanda, gave embassy and international organization representatives a preview of its findings, which it expects to formally present to the IMF board on August 24.

The Economy at Large

¶3. (SBU) The overall economic indicators are good, McDonald reported, with real 2006 overall GDP growth at 19 percent and real 2007 overall GDP growth estimated at 35 percent. The oil sector should grow 40 percent and the non-oil sector 25 percent. With 2006 inflation at 12 percent, the GRA has a chance of meeting its policy goal of 10 percent this year, said McDonald. One participant noted that every item he sees except gasoline has risen more than 12 percent in the last year. McDonald conceded that the items in the CPI market basket and the weights given to them are in need of updating. The government,s recent moves to appreciate the currency show the importance it gives to controlling inflation, he continued, by keeping down the cost of imported goods. (Note: Since the BNA cannot control the interest rate, its only instrument is the nominal exchange rate. End note.)

Ambassador Efird asked whether the GRA had yet developed a way to enforce coherency on fiscal policy. McDonald conceded that tensions between the National Bank of Angola (BNA) and the Ministry of Finance (MOF) continue. Although the BNA,s foreign exchange operations cause it to operate at a loss, it still has not been recapitalized by the MOF.

¶4. (SBU) Government revenues, fed by oil income, have exceeded the GRA,s capacity to execute its growing budgets. Although the 2007 budget was drafted as a deficit budget, Mc Donald explained, it will probably, as in 2006, only be able to execute 50 percent of its USD 15.5 billion capital budget, leaving the GRA with a surplus equal to 2.5 percent of the GDP in addition to last year,s slightly smaller surplus. Angola,s reserves have also more than doubled this year, from USD 3.5 billion to USD 8.5 billion. The cushion of reserves permitted the GRA to pay the principal and part of the interest on its debt to members of the Paris Club, although penalty interest remains outstanding. McDonald He reported that the IMF had been told by the GRA hat it is reconciling its own data on amounts owed and paid. (Some countries have been overpaid, others underpaid due, apparently, to GRA accounting difficulties.) When this reconciliation is completed the Minister of Finance will approach the Paris Club again. The IMF, he continued, is &neutral8 on Paris Club issues but has encouraged Angola to regularize its relationship to its creditors as soon as possible.

The Fiscal Sustainability Challenge

¶5. (SBU) On mid-term issues where the IMF has engaged the GRA, and challenged it to develop the capacity to plan beyond the current two-year horizon. Mc Donald sees the GRA facing

several challenges. First, that of fiscal sustainability, i.e., designing budgets and encouraging economic growth in the non-oil sector that will carry the GRA over any future oil production decline or any shock from falling oil prices. (Note: The IMF does not include possible future discoveries in its calculations and thus looks at Angola as reaching its peak production in 2012. End note.)

The Debt Sustainability Challenge

¶6. (SBU) Angola,s second major challenge is debt sustainability. McDonald estimated that for the long-term Angola is at a medium risk of debt distress, although he clarified that the Article IV team has still not finished its analysis of the debt data it has collected during this visit. He described the GRA as very forthcoming in supplying information on debt and credit lines. Poverty reduction and long-term debt sustainability will require a stronger non-oil economy. While the construction sector has begun to grow, so must other sectors. Angola has to change its regulatory environment in order to attract more foreign direct investment (FDI). For the sake of debt sustainability, McDonald argued, the GRA needs a clear fiscal rule to mandate saving oil revenues when prices rise above a determined level. (Note: Angola,s Deputy Prime Minister, Aguinaldo Jaime, described a similar mechanism to A/S Frazer, septel.) When revenues fall, the GRA will have to decide whether to spend its reserves, cut spending, borrow or adjust the exchange rate. The IMF also discussed the intergenerational transfer of oil wealth with the GRA, but met with little response.

Structural Issues

¶7. (SBU) Among structural issues facing Angola, McDonald identified the management of public finances. Although public investment projects make up a large fraction of the budget, the GRA does not have the means to manage effectively and guard against waste. The Ministries of Finance and Planning need to coordinate better when preparing the budget

and executing it. The GRA must also start budgeting for maintenance and operation of the new roads and buildings funded through public investment projects. He cautioned that capital and current accounts budgets must be reconciled. The IMF has prepared a Fiscal Report on the Observance of Standards and Codes (a Fiscal ROSC), which addresses this problem but has not yet been approved by the GRA and therefore has not been published. In response to ea question, McDonald elaborated that the IMF continued to believe that Sonangol operations should be more transparent with Sonangol,s role as an operator separate from its role in granting concessions.

Angola,s Relationship with the IMF

¶8. (SBU) In answer to a question, McDonald said that the IMF has adjusted to the GRA,s decision earlier this year not to enter into a structured agreement with the IMF and is moving forward with consultations and sharing its expertise with the Angolan financial sector.

Comment

¶9. (SBU) This yeQ,s article IV visit is an opportunity for both the IMF and the GRA to test a relationship that will continue, but without the structural agreement that for years had seemed to be just around the corner. The team may change some of its conclusions based on further analysis of data, but McDonald,s narrative stayed close to previous IMF discussions of Angola. In conversation after the briefing, McDonald indicated that most of the hard problems, like Sonangol,s dual role, remain the subjects of future discussion, leaving the IMF to concentrate now on areas where it can make progress in modernizing the financial system and strengthening the relationship between the IMF and its GRA counterparts.
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